**DEPARTMENT OF STATE REVENUE**
**LETTER OF FINDINGS NUMBER: 97-0117 ST**

**Sales/Use Tax — Manufacturing Exemption**
**Sales/Use Tax — Public Transportation**
**Tax Administration — Penalty**
**For Tax Periods: 1993 through 1995**

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## ISSUES

### I. Sales/Use Tax — Manufacturing Exemption - Storage Tanks

**Authority:** IC 6-2.5-5-3
45 IAC 2.2-5-8; 45 IAC 2.2-5-10(k)

Taxpayer protests assessments of Indiana use tax on its stationary industrial bulk storage tanks.

### II. Sales/Use Tax — Manufacturing Exemption - Rental of Storage Tanks

**Authority:** IC 6-2.5-5-3
45 IAC 2.2-4-27

Taxpayer protests assessments of Indiana sales tax on its rental of storage tanks to its sister companies.

### III. Sales/Use Tax — Public Transportation

**Authority:** IC 6-2.5-5-3; IC 6-8.1-5-1; IC 6-2.5-5-27
45 IAC 2.2-4-27; 45 IAC 2.2-5-8(f)
*National Serv-All, Inc. v. Indiana Department of State Revenue,* 644 N.E.2d 954 (Ind.Tax 1994)

Taxpayer protests assessments of Indiana use tax on its purchase of transportation equipment and repair parts.

## IV. Tax Administration — Penalty

**Authority:** IC 6-8-10-2.1
45 IAC 15-11-2; 45 IAC 2.2-3-20

Taxpayer protests the imposition of a ten-percent (10%) negligence penalty.

## STATEMENT OF FACTS

Taxpayer sells welding supplies and industrial gases. Taxpayer receives its gas in liquid form. In many instances, prior to resale, Taxpayer must convert the gas into a non-liquid, compressed state. In addition to retailing, Taxpayer delivers the gas that is sells. At issue are Audit's proposed assessments of use tax on Taxpayer's purchase and rental of industrial storage equipment as well as Taxpayer's purchase of transportation equipment and repair parts.

## I. Sales/Use Tax — Manufacturing Exemption - Storage Tanks

## DISCUSSION

Taxpayer purchased stationary industrial bulk storage tanks and parts to store various types of gases. Taxpayer did not pay sales tax on these acquisitions. As a result, Audit proposed additional assessments of use tax.

Audit relies on 45 IAC 2.2-5-8(e), which explains:

> Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.

Taxpayer, in response, points out its stationary industrial bulk storage tanks were used for more than just the storage of raw materials (pre-production activity) and finished products (post-production activity). Taxpayer argues its stationary industrial storage tanks were directly used in its manufacturing process and therefore, should enjoy exempt status.

Taxpayer describes the utility of these stationary industrial bulk storage tanks in the context of its manufacturing process:

> The [stationary industrial bulk storage] tanks are plumbed so the product [gases] can be changed from a liquid state to a vapor state. It [gas] is sold to the customer in a vapor state. Often various products are blended together to meet customers

> particular specifications. The tanks in question have various pressure valves, fittings, and nozzles that allow this [processing] to take place.

In support of its plea for exempt status, Taxpayer cites the "double direct" language of IC 6-2.5-5-3(b), which reads:

> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

As the gas is primarily sold in a non-liquid state, and the stationary industrial bulk storage tanks are used to convert liquid gas into a non-liquid, Taxpayer reasons the storage tanks must be part of its production process.

The conversion of substance—from liquid to gas—represents a type of processing activity referenced by IC 6-2.5-5-3(b). In the context of production (in contrast to consumption or incorporation):

> Processing or refining is defined as the performance by a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that is which it was acquired. The change in form, composition, or character must be a substantial change.…

45 IAC 2.2-5-10(k).

Taxpayer utilizes its stationary industrial bulk storage tanks for two distinct purposes—one taxable, one exempt. Storage of liquid product represents a taxable use; conversion of liquid to gas, an exempt one. Consequently, exemption must be determined on a pro-rata basis.

## FINDING

Taxpayer's protest is sustained to the extent its stationary industrial bulk storage tanks are used for conversion purposes.

## II. Sales/Use Tax — Rental of Storage Tanks

## DISCUSSION

Taxpayer (lessor) rented storage tanks to two sister companies. Taxpayer did not issue invoices but did make journal entries to account for the rental income. Taxpayer also included this rental income in its Indiana gross and adjusted gross income. Taxpayer, however, failed to collect and remit sales tax on its rental receipts.

Audit determined Taxpayer should have collected and remitted sales tax on these rental transactions. In reaching its conclusion, Audit relied on 45 IAC 2.2-4-27, which reads in part:

> In general, the gross receipts from renting or leasing tangible personal property are taxable. *This regulation [45 IACC 2.2] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction* (emphasis added).

Taxpayer, on behalf of its lessees, invokes one of Indiana's "industrial" exemptions.

In Indiana, it is not the lessor's responsibility to determine whether a particular transaction is exempt. Rather, it is Taxpayer's customer (in this instance, the lessee), who determines—at least initially—the exempt status by issuance of exemption certificates. As IC 6-2.5-8-8(a) instructs:

> A person…(b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. **A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.** (emphasis added.)

The Department, however, will adjust these proposed assessments to the extent Taxpayer can obtain valid exemption certificates from its lessees.

## FINDING

Taxpayer's protest is denied.

## III. Sales/Use Tax — Public Transportation

## DISCUSSION

Taxpayer sells highly flammable and hazardous gases. These gases are sold and transported in returnable storage containers primarily owned by Taxpayer. Shipping terms indicate F.O.B. Taxpayer's location. Some customers prefer to pick up their purchases at Taxpayer's dock. Most do not. Since Taxpayer has the proper permits (I.C.C. and P.S.C.I.), Taxpayer provides for the delivery of its products (gas and cylinders). To that end, Taxpayer purchased, exempt, transportation equipment and repair parts. Audit, in response, proposed assessments of use tax on these items.

Taxpayer reasons since it is in the business of "rendering transportation of property for hire," its purchases of transportation equipment and repair parts should have been exempt from Indiana sales/use tax. Taxpayer directs the Department's attention to IC 6-2.5-5-27, which informs:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, *if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property* (emphasis added).

Taxpayer submitted a copy of its sales agreement which states that vendor's "[p]roducts are sold FOB [taxpayer's location]." Additionally, Taxpayer provided the Department with a copy of its standard billing invoice. The delivery charge is separately stated. A "Release of Customer" section can be found on the back of the invoice. This language warns the buyer of the dangers of transporting the product in any manner other than by open truck. Taxpayer explains: *"Please note on the "Release of Customer" [section] on the back of the billing. The customer can elect to transport the product by their own means."* Taxpayer argues this language—together with the FOB language and separately stated delivery charges—conclusively indicates that it is transporting the goods of another for consideration.

For Taxpayer to qualify for any of the "public transportation" exemptions, the tangible personal property purchased must be directly used or consumed in the rendering of public transportation of either persons or property. IC 6-2.5-5-27. "Public transportation," a term of art, is defined in the following manner:

> Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household good carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission…; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in the transportation of persons or property for consideration as defined above.

45 IAC 2.2-5-61(b).

In other words, to qualify for the public transportation sales/use tax exemptions, Taxpayer must have been engaged in **(1)** the transport **(2)** of persons or property **(3)** for compensation **(4**) by either highway, rail, air, or water **(5)** under the authority of the P.S.C.I. or I.C.C.—unless Taxpayer is specifically exempt from such economic regulation.

Taxpayer must also show its use of the purchased items was *predominantly* for public transportation purposes. *National Serv-All, Inc. v. Indiana Department of State Revenue*, 644 N.E.2d 954,959 (Ind.Tax 1994). Indiana courts have noted that the "public transportation" activity must be done *for consideration*. Or stated more succinctly, "someone other than the transporter must own the property being transported." *Id*. at 956. And this is where Audit and Taxpayer disagree. Audit believes Taxpayer, as seller, is transporting its own products. Taxpayer, on the other hand, contends the items being transported belong to others—i.e., to its customers.

All parties agree that Taxpayer is **(1**) transporting **(2)** property **(3)** over public highways **(4)** under the authority of the P.S.C.I. and the I.C.C. But is such transport rendered for compensation—i.e., is Taxpayer transporting for another, or for itself? In other words, who owns the property being transported—Taxpayer, or its customers?

Ownership is a malleable concept. *National Serv-All, Inc., v. Indiana Department of State Revenue*, 644 N.E.2d 954, 957 (Ind.Tax 1994). The road to "ownership," in this instance, requires the Department to determine which party possessed legal title to the goods at the time of shipment. The Department, therefore, will look to the Agreement and, if necessary, the conduct of the parties, to determine their intent with regard to transfer of title. The Department takes note of the Court's advice:

> In construing a contract [the court] must be guided by the intent of the parties and ordinarily that intent is determined by examining the four corners of the written document (internal cite omitted).

*Id.*

The transactions at issue were made pursuant to written agreements. Absent from these agreements was any discussion regarding "transfer of title." "Delivery" terms, however, were prominently discussed. Taxpayer provided the Department with a representative "Service Agreement." Some of its more salient terms include:

> **2.** Seller [Taxpayer] agrees to supply Buyers requirements of *****GAS***** utilizing a bulk method of delivery to Buyer's location(s) at *****LOCATION*****.
>
> **6.** Delivered prices for the product(s) specified herein apply to deliveries made during normal business days….Seller shall not be obligated to make any delivery of product in a quantity less than 75% of the capacity of Seller's bulk storage unit…
>
> **14.** Buyer's requirements of the product(s) covered by this Agreement shall be defined to be the quantity required under normal conditions existing at the time this Agreement was entered into between the parties; therefore, Seller shall not be obligated to deliver to Buyer increased quantities of such product(s) unreasonably disproportionate to Buyer's normal prior requirements or in excess of Seller's producing and delivering capabilities.
>
> **24.** Buyer agrees to pay Seller for the net quantity of such products delivered to each location during any calendar month in accordance with the following price schedule. Products are sold FOB [Taxpayer's location].

Taxpayer also provided the Department with a copy of a typical invoice which included the following language:

> UNLESS OTHERWISE STATED, THE CYLINDERS ON THIS DOCUMENT ARE THE PROPERTY OF VENDOR [Taxpayer]. BY ACCEPTANCE OF THIS DELIVERY, THE CUSTOMER ASSUMES RESPONSIBILITY FOR THE COUNT AND THE DOLLAR VALUE OF ANY CYLINDER LOST OR DAMAGED. CLAIMS FOR SHORTAGES MUST BE MADE WITHIN 10 DAYS.

The reverse side contained a "RELEASE OF CUSTOMER" section, which read in part:

> The undersigned customer is buying industrial specialty, or medical gases from Vendor which the customer elects to transport by car, van, or other closed motor vehicle.
>
> The undersigned customer acknowledges specific warning of the following:
>
> > **3**. It would be safer to wait and move the cylinder(s) by open truck, or let Vendor do it.

After reviewing Taxpayer's Service Agreement ("Agreement") the Department finds the terms clearly indicate the parties intention that delivery was part of the bargain. The contract offered by Taxpayer (seller) to its customers (buyers) was entitled "Service Agreement." *(An indication that more than tangible personal property was being purchased.)* Additionally, terms of the Agreement included both buyers' and the seller's obligations with regard to the delivery of the product.

Two terms are particularly relevant:

> **2.** Seller [Taxpayer] agrees to supply Buyers requirements of *****GAS***** utilizing a bulk method of delivery to Buyer's location(s) at *****LOCATION*****; and
>
> **24.** Buyer agrees to pay Seller for the net quantity of such products delivered to each location during any calendar month in accordance with the following price schedule. Products are sold FOB [Taxpayer's location].

Taxpayer charged only a nominal fee (ten dollars) for product delivery.

And finally, commonsense compels characterization of these transactions as sales for "delivered product." The product sold (volatile gas) required careful handling—especially during delivery. Taxpayer, as seller of the product and lessor of the storage equipment, was the party most knowledgeable, and best equipped, to ensure safe delivery.

The Department also notes that its findings are consistent with the relevant provisions of the Uniform Commercial Code as codified by the Indiana General Assembly. To wit, IC 26-1-2-401(2) instructs:

> Unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods…
>
> **(a)** if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but
>
> **(b)** if the contract requires delivery at destination, title passes on tender there.

Since the Agreement was for delivered product, transfer of title did not occur until the product was delivered to its buyers' locations. As Taxpayer still owned the product being delivered,

Taxpayer was not transporting products for consideration. Taxpayer, therefore, was not providing "public transportation" services.

**FINDING**

Taxpayer's protest is denied.

## IV. Tax Administration — Penalty

**DISCUSSION**

Taxpayer protests the imposition of the ten-percent (10%) penalty. The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and 2prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

While Taxpayer has not prevailed on all the assessed items, the Department believes application of the negligence penalty would be inappropriate in this instance.

**FINDING**

Taxpayer's protest is sustained.

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